

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 95-0152

**Withholding Tax
For The Period: 1991**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Withholding Tax – S Corporations

Authority: IC 6-3-4-13 (a); IRC Sec. 1362(a)

The taxpayer protests the Indiana Withholding Tax as applied to its nonresident shareholders in 1991.

II. Tax Administration - Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2

The taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

The taxpayer is a corporation formed under the laws of Kentucky but located in the State of Indiana. The taxpayer elected to be treated as an S corporation pursuant to IRC Sec. 1362 (a). Since the taxpayer's shareholders were not residents of the State of Indiana during the period at issue, the shareholders filed Indiana nonresident returns for that year.

I. Withholding Tax – S Corporations

DISCUSSION

The taxpayer argues that the Indiana withholding provisions in IC 6-3-4-13 (a) would apply to

them only if actual payments or credits were made to its shareholders. The taxpayer did not pay dividends to its shareholders during the tax year ending December 31, 1998. The requirement to

withhold income from nonresident shareholders is contained in IC 6-3-4-13(a), which in the period at issue (1991) provided in pertinent part:

Every corporation which is exempt from tax under IC 6-3 pursuant to IC 6-3-2-2.8(2) shall, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, deduct and retain therefrom the amount prescribed in the withholding instructions referred to in section 8 of this chapter.

The taxpayer states that no dividends were paid to its shareholders during the tax period at issue. The taxpayer argues that the language in the statute directs the corporation to "deduct and retain" the applicable amount of withholding tax from amounts paid or credited to its shareholders. The taxpayer contends that if no actual dividends are paid to nonresident shareholders, it would be impossible for the corporation to "deduct and retain" withholding taxes from a nonexistent payment. Thus, the taxpayer claims that the withholding provisions would apply to the taxpayer during 1991 if actual payments or credits were made, as required under IC 6-3-4-13 (a).

The taxpayer asserts that when the Indiana Legislature amended this section in 1994, they intended to change the withholding requirements of that section to allow for nonresident withholding with respect to the undistributed earnings of a corporation. The argued intention of the legislature was to confirm that some type of actual dividend payment or credit was required before a withholding obligation was created for the taxpayer before the 1994 amendment. The statute was amended as follows:

Every corporation which is exempt from tax under IC 6-3 pursuant to IC 6-3-2-2.8(2) shall, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, withhold the amount prescribed by the department.

The 1994 amendment to IC 6-3-4-13 did not change the requirements for withholding in regard to nonresident shareholders of corporations. The amendments served only to clarify the statute. The statute's function is to protect the State of Indiana from loss of tax revenues if a corporation doing business in the state passes its benefits to nonresident shareholders who are then out of reach from the state for tax collection purposes. The proper treatment of distributions from an Indiana S corporation to a nonresident shareholder is for the corporation to withhold the proper tax, and then for the shareholder to file a nonresident return and claim the applicable credit, if any, for the taxes paid on his Indiana income in the state of his/her residence. There is a duty on the part of an S corporation to withhold the proper amounts and is liable to the state for the tax that should have been withheld.

FINDING

The taxpayer's protest is denied. Indiana Code 6-3-4-13 (a) requires an S corporation doing business in Indiana to withhold tax on income credited or paid to nonresident shareholders. The taxpayer states in their letter of protest that a nonresident shareholder who filed an Indiana Nonresident Individual Income Tax Return was not included in the Computation of Deemed Tax Paid Indiana Credits. The Audit Division is requested to review this and provide credit if proper.

II. **Tax Administration** – Penalty

DISCUSSION

The taxpayer further requests the abatement of the negligence penalty. Indiana Code 6-8.1-10-2.1 states, in part, that if “the deficiency determined by the Department was due to reasonable cause and not willful neglect, the Department shall waive the penalty.” Regulation 45 IAC 15-11-2 also states,

(b) “Negligence” on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer.

The Department finds that the deficiency was due to reasonable cause. The taxpayer’s interpretation of Indiana law as codified in 1991 was reasonable, even though erroneous. The penalty assessment is waived.

FINDING

The taxpayer’s protest is sustained. The negligence penalty is waived.